

# Michigan SB 930

Cigarettes made by cigarette manufacturer

Pipe tobacco cigarettes made by RYO machines at retail

Master Settlement Agreement (MSA)	Applicable	Master Settlement Agreement (MSA)	Applicable
• Payments and fees	YES	• Payments and fees	NO
• Advertising Restrictions	YES	• Advertising Restrictions	NO
• Directory Registration	YES	• Directory Registration	NO
Fire-safe cigarette standards	YES	Fire-safe cigarette standards	NO
US Surgeon General's warning on packaging	YES	US Surgeon General's warning on packaging	NO
FDA ban on use of "low," "lights," or similar descriptors	YES	FDA ban on use of "low," "lights," or similar descriptors	NO
FDA ban on characterizing flavors	YES	FDA ban on characterizing flavors	NO
FDA ban on free cigarette samples	YES	FDA ban on free cigarette samples	NO
FDA ingredient reporting	YES	FDA ingredient reporting	NO
FDA substantial equivalence filings	YES	FDA substantial equivalence filings	NO
FDA disclosure of changes or additions	YES	FDA disclosure of changes or additions	NO
FDA registration and product listings	YES	FDA registration and product listings	NO
FDA ban on self-service displays	YES	FDA ban on self-service displays	NO
FDA ban on sponsorships	YES	FDA ban on sponsorships	NO
FDA ban on non-tobacco items and gifts	YES	FDA ban on non-tobacco items and gifts	NO
FDA minimum pack size of 20	YES	FDA minimum pack size of 20	NO
Federal and state cigarette excise tax paid	YES	Federal and state cigarette excise tax paid	NO

\* Other Tobacco Products (OTP) Tax paid on cigarette tubes and loose tobacco

*Lorillard*

Information provided by Lorillard Tobacco Company  
2/14/12

# Cigarettes Made By Retail Cigarette Manufacturing Machines in Michigan Could Evade \$34.75 in

## Taxes per Carton

*Retail Cigarette Manufacturing machines produce cigarettes that are evading federal and state taxes and fees. In addition federal excise tax rates are being avoided by using pipe tobacco, which is taxed at a lower rate.*



Cigarettes		Retail Manufacturing Machine-Made Cigarettes
\$10.10	Federal Excise Tax	\$1.15
\$20.00	State Excise Tax	\$2.19
\$3.68	State Sales Tax	\$1.80
\$6.10	MSA	\$0.00
\$39.88	Total	\$5.14
Difference = \$34.75/carton		

### Notes on calculations:

NOTE: These tax estimates are made by using Pipe Tobacco, which is being used in place of RYO tobacco to evade FET and other fees. Numbers may not add due to rounding.

State Excises Taxes: Tax rates on cigarette packs and pipe tobacco are from Bill Orzechowski & Rob Walker, *The Tax Burden on Tobacco*, vol. 45 (February 2011); funded in part by Altria Client Services Inc. RYO state excise tax amount assumes 6.5 ounces of pipe tobacco are used per carton and taxed at the Michigan other tobacco product tax rate of 32.0%. The price pipe tobacco price is estimated at \$6.83 per carton, which is based on a \$1.05 per-ounce average of 10 brands of pipe tobacco.

Federal Excise Taxes: Tax rates on cigarette packs and pipe tobacco are from Alcohol and Tobacco Tax Trade Bureau, *Federal Excise Tax Increase and Related Provisions*, available at [http://www.ttb.gov/main\\_pages/schipp-summary.rv.shtml](http://www.ttb.gov/main_pages/schipp-summary.rv.shtml) pipe tobacco federal excise tax amount assumes 6.5 ounces of pipe tobacco are used per carton at a rate of \$2.83 per pound.

Sales taxes: Tax rates are from the Federation of Tax Administrators, available at <http://www.taxadmin.org/fta/rate/sales.pdf> Sales tax amount is calculated by multiplying the Michigan sales tax rate of 6.0% times the sales price of each type of cigarette. The price of traditional cigarettes is estimated by multiplying average per-pack prices reported in Tax Burden on Tobacco by 10. The price for an RYO carton is estimated at \$20.76, which is the average range of RYO prices reported by the Alcohol and Tobacco Tax Trade Bureau in TTB Ruling, Sep. 30, 2010, at <http://www.ttb.treas.gov/rulings/2010-4rule.pdf>.  
MSA Settlement: The estimated settlement cost per pack are from PM USA internal data.

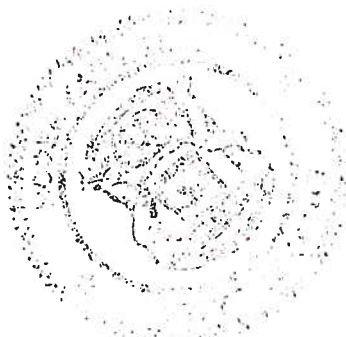


Information provided by Altria Client Services Inc. on behalf of Philip Morris USA Inc.  
For more information, please visit [www.pmusai.com](http://www.pmusai.com)

02/13/2012

## LEGAL CONCERNS RE: COMMERCIAL ROLLING MACHINES

- Allowing tobacco retailers who own or operate large, commercial cigarette rolling machines to sell large quantities of unstamped, unlabeled cigarettes severely undercuts both the Michigan requirement that cigarette packs be stamped and the Federal requirement that health warning labels be placed on cigarette packaging.
- Tobacco retailers who own or operate large, commercial cigarette rolling machines seriously undercut the price other retailers can charge for cigarettes because the machines use only pipe tobacco (and not cigarette rolling tobacco) to manufacture the cigarettes. *[See attached for fiscal impact of using pipe tobacco in cigarettes.]*
- Tobacco retailers who own or operate large, commercial rolling machines do not use the fire-safe cigarette tubes that are required by Michigan law. In fact, some of these tobacco retailers boldly market their cigarettes as being rolled from nonfire-safe cigarette tubes.
- Cigarettes manufactured by tobacco retailers who own or operate large, commercial rolling machines are not sold in packs containing the cigarette tax stamp required by Michigan law. Instead, they are sold in bags of individual cigarettes that result in Michigan receiving substantially less tax revenue than if they were sold in properly stamped packs. *[See attached for fiscal impact of using pipe tobacco in cigarettes.]*
- The individual cigarettes sold by tobacco retailers who own or operate large, commercial rolling machines (known as "loosies") are much more likely to end up in the hands of children and other minors. This is because minors who cannot afford an entire pack of properly stamped cigarettes (\$5) can afford to buy 1 or 2 cigarettes at approximately 15 to 20 cents each.
- Allowing tobacco retailers who own or operate large, commercial rolling machines to manufacture cigarettes using pipe tobacco and without becoming licensed as a manufacturer could potentially put Michigan's \$300,000,000.00 annual revenue from the Master Settlement Agreement (MSA) in jeopardy. Because the owner/operators of the machines are manufacturing cigarettes and using pipe tobacco to do so (instead of roll your own cigarette tobacco), Michigan law requires that the retailer/manufacturer become licensed as a manufacturer (MCL 205.423), establish an escrow account (MCL 205.426c) and pay the equity assessment on those cigarettes (MCL 205.426d). Michigan's failure to diligently enforce the MSA by enforcing those requirements could make the State vulnerable to legal challenge.





## FISCAL CONCERNS RE: COMMERCIAL ROLLING MACHINES

- For the reasons discussed below, tobacco retailers who own or operate large, commercial cigarette rolling machines are able to sell the equivalent of a carton of cigarettes for approximately \$20 to \$35 less per carton than other cigarette retailers. This makes it difficult or impossible for supermarkets, drug stores, convenience stores, gas stations and other tobacco retailers to compete.
- The reason tobacco retailers who own or operate large, commercial cigarette rolling machines are able to severely undercut the price other retailers must charge for cigarettes is because the rolling machines are producing cigarettes with pipe tobacco, not cigarette rolling tobacco, and because of the difference in tax rates on those tobacco types.
- In 2009, the federal government increased the federal tax on cigarette rolling tobacco to \$24.78 per pound. This was done in part to equate the federal tax on loose tobacco used to roll cigarettes with the federal tax on cigarettes. However, the federal government only increased the tax on pipe tobacco to \$2.83 per pound. Because there is no clear definition of pipe tobacco, tobacco manufacturers have begun to label virtually all loose tobacco sold in the U.S. as "pipe tobacco."
- To understand the impact on Michigan's tax revenue that retailers who manufacture and sell cigarettes made of pipe tobacco, consider these 2 scenarios:

**Scenario 1:** A retailer sells 60 cartons of properly stamped cigarettes each day. If each carton sells for \$55.00, Michigan will receive \$20.00 in tobacco tax and \$3.30 in sales tax for each carton sold. If that amount is multiplied by 60 cartons, Michigan will receive a total of \$1,398.00 in tobacco and sales tax per day. In one year, Michigan will receive \$510,270.00 in tax revenue from that single retailer. If the retailer sells 200 cartons each day, Michigan would receive \$1,700,900.00 in tax revenue from that single retailer.

**Scenario 2:** A retailer operating a commercial rolling machine uses pipe tobacco to roll the equivalent of 60 cartons of cigarettes. If the retailer uses 1 pound of pipe tobacco in order to produce 1 carton of cigarettes, Michigan will receive approximately \$2.88 in tobacco tax and 73 cents in sales tax for each "carton" sold. If that amount is multiplied by 60 cartons, Michigan will receive a total of \$216.60 in tobacco and sales tax per day. In one year, Michigan will receive \$79,059.00 in tax revenue from that retailer. If the retailer sells 200 "cartons" each day, Michigan would receive \$263,530.00 in tax revenue from that retailer—or \$1,437,370.00 less in tax than in Scenario 1. Note too that if 80 machines are operating in Michigan at present (our estimate is 80 to 100), Michigan could potentially lose approximately \$114,989,600.00 annually in tax revenue.

- The production of cigarettes by unlicensed manufacturers using pipe tobacco in rolling machines causes Michigan to lose \$3.50 per carton in equity assessment revenue (MCL 205.426d). Potential lost revenue of about \$250,000.00 annually for a single retailer selling 200 cartons per day, or \$20,000,000 for 80 such retailers. It also prevents Michigan from funding the escrow account required by the TPTA. Finally, it could result in a reduction of the \$300,000,000.00 in annual revenue Michigan receives under the Master Settlement Agreement (MSA).



*Michigan Department of Treasury*

**Response to points raised from Roll Your Own (RYO) Manufacturers**  
**Office of Senator Kahn**

RYO Statement: Under their (RYO) commercial agreements, all of their distributors and retailers are required to follow federal, state, and local law.

**Answer: RYO cigarette manufacturers do not follow any state and federal cigarette regulations such as Surgeon General warnings, labeling laws, fire-safety compliance, flavoring bans, restrictions prohibiting selling to minors, etc. In addition, they avoid federal and state cigarette excise taxes, Michigan MSA payments and Michigan sales tax.**

RYO Statement: California's Board of Equalization said in 2011 that retailers are not manufacturers.

**Answer: California is at odds with most other states dealing with this tax avoidance matter. They are also at odds with the federal government on this point. Michigan is attempting to join with most other states working to find a solution to this growing problem.**

RYO Statement: RYO stores cannot comply with a requirement that they be treated as cigarette manufacturers.

**Answer: This statement is false. Any RYO operator can fill out the form and apply to be a manufacturer.**

RYO Statement: Under federal law a permit to manufacture tobacco products can only be granted to entities "whose principle business activity" is the manufacturer of tobacco products. These retailers' principle business is not manufacturing, it's the sale of tobacco products. Retailers are 'foreclosed' from getting a permit.

**Answer: RYO manufacturers are clearly manufacturing cigarettes and should not be treated differently. More and more RYO machines are popping up across the state. The sales and manufacturing of these RYO cigarettes are booming. One RYO manufacturer who testified in committee stated that his store is averaging 60 cartons of RYO cigarettes daily. This means tax avoidance at this store alone of \$2,100 daily which translates to \$63,000 in tax avoidance monthly. Certainly this is a substantial portion of their business income and could be argued this is their principal activity.**

RYO Statement: Rosenthal reiterated the "tax neutral aspect" of RYO that the previous speaker (Jim Cavanagh) mentioned.

**1**  
**2** **Answer: RYO manufacturers have an extreme tax "avoidance" advantage in manufacturing these cigarettes. A simple comparison of a carton of cigarettes (regular vs. RYO) shows that RYO operators are avoiding \$35 per carton. In addition, they are avoiding the \$3.50 per carton in equity assessment/escrow requirements.**

RYO Statement: MI goes after not only the retailer but the consumer as well, because this makes a manufacturer of the consumer who uses one of these machines.

**Answer: Not true. SB930 deals only with commercial RYO operators, not people who roll their own cigarettes for personal use. If people buy loose tobacco and papers, just like they always have, they are not affected at all by this legislation. SB930 only deals with the "commercial" production/manufacturing of cigarettes.**